EUROPEAN COMMISSION

PUBLIC VERSION

WORKING LANGUAGE

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Brussels, 19.12.2012
C(2012) 9463 final

Subject: **State aid SA.34086 (2012/N) – Hungary**

Investments aiming at the modernisation of the Hungarian energy sector under Article 10 c) EU ETS Directive.

Sir,

The Commission wishes to inform you that the aid granted through the scheme on transitional free allocation of greenhouse gas emission allowances under the Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the EU and amending Council Directive 96/61/EC, as amended by Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 (hereinafter jointly referred to as the "EU ETS Directive") is compatible with the internal market in accordance with Article 107(3)(c) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") and has therefore decided not to raise objections to the notified measure.

1. PROCEDURE

1. Following pre-notification contacts, Hungary notified its proposed measure on 26 November 2012 by electronic notification, registered by the Commission on the same day.

2. Before the notification, on 1 February 2012, the association of the Hungarian Institute of Energy Efficiency (Magyar Energiahatékonysági Intézet hereinafter: MEHI) filed a complaint registered as case SA.34520 (2012/CP) against the National Plan for Investments allegedly envisaged at the time by Hungary.

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2. DESCRIPTION

2.1. Background and objective

3. Article 10c of the EU ETS Directive allows Member States whose electricity systems meet certain criteria to provide for the allocation of emission allowances free of charge to installations for electricity production in operation by 31 December 2008 or for which the investment process was physically initiated by the same date, for a transitional period, from 2013 until 2019.

4. Member States which pursue this option must fulfil certain conditions in relation to the modernisation of their energy system (including retrofitting and upgrading of the infrastructure, introduction of clean technologies and diversification of their energy mix and sources of supply). In particular, in exchange for granting free allowances to power generators, such Member States have to present a national investment plan setting out the investments undertaken by the recipients of the free allowances or by other operators of an amount at least equal to the value of the corresponding emission allowances allocated for free.

5. On 30 September 2011 Hungary notified to the Commission pursuant to Article 10c(5) of the EU ETS Directive including the National Plan ("national plan") which sets out eligible investments that may take place to modernise electricity generation during the period of transitional allocation of free allowances. Hungary also formally notified its intention to make use of the option provided by Article 10c of the EU ETS Directive under Article 108(3) of the TFEU.

6. By Decision of 30 November 2012, the Commission decided not to raise objections to the Hungarian application to transitionally allocate allowances free of charge to installations for electricity production in the period 2013-2019 pursuant to Article 10c(5) of the Directive[1]. In that Decision (recital 13), the Commission reminded Hungary that it cannot put into effect the planned aid measures until the Commission has adopted a final decision that the state aid involved is compatible with the internal market.

2.2. Main features of the aid scheme, granting authority

7. The Hungarian authorities note that the country's energy sector is currently reliant on low-efficienct power sources, which account for more than half of the domestically generated electricity. Most power plants in Hungary are obsolete and the rate of their use of primary energy sources, environmental pollution and labour demand are higher than the EU average. Existing coal-fired power plants still play an important role in the electricity generation, but are older than their planned life cycle and their efficiency ratio, environmental parameters and CO_2 emissions fail to meet today’s requirements. Currently, the carbon intensity of electricity generation in Hungary accounts for 0.370 kgCO_2/kWh, which is close to the European average. In order to ensure sustainability, the Hungarian State intends to reduce the current level of carbon intensity to approximately 0.200 kg CO_2/kWh by 2030. .

[1] C(2012) 8675.

8. Furthermore, the Hungarian authorities note that the majority of the units operating in the Hungarian system are suitable for base load operation and therefore system control with technical tools becomes more and more difficult, in particular with regard to off-peak downward regulation. The unit capacity of the power plant blocks, which were built to accommodate a former less integrated national market, also falls behind today's competitive block capacity levels. In addition, system control in Hungary is currently performed with obsolete and uneconomic fossil fuelled power plant blocks, originally built for other purposes. These blocks, with a typical capacity of 200 MW, ensure the secondary reserves in the system. Under the current conditions, the lack of the required reserves may lead to a situation even within a few years, where the handling of capacity shortages will not be possible anymore. In addition, the development of renewable energy sources is significantly low, which is, at least partially, due to the inflexibility of the electricity grid and the absence of a smart grid solution.

9. Hungary's national plan was initially approved on 28 September 2011 but was subsequently substantially modified. The plan foresees two strategic system-level investments that may help to restructure the Hungarian energy sector. It plan addresses the above issues by increasing supply of low-carbon gas for energy production, thereby allowing for new entry and/or increased competition on the energy market and a more efficient network working system operation. While the national plan covers the period until 2020 Hungary expressed that it shall allocate free allowances only in 2013. The realisation of the projects finally included in the national plan is envisaged to continue thereafter.

10. According to the Hungarian authorities, the use of Article 10c of the EU ETS Directive and the allocation of free allowances would allow the country to meet these objectives and more generally to speed up the modernisation of its energy sector. Accordingly, Hungary envisages that it would allocate free emission allowances to operators which are required to transfer the market value to the National Inspectorate for Environment, Nature and Water (the Monitoring Authority) in exchange for receiving the allowances for free. Subsequently, the investors may request the Monitoring Authority to receive funds to finance the investments listed in the national plan. However, an investor may receive payments only to cover already incurred eligible costs and expenses arising in connection with implementing an investment from the national plan (ex-post transfers).

11. In addition to the above, the Hungarian authorities have applied a list of criteria with which the investments wishing to receive funds had to comply. Such criteria are the following:

- the investment shall directly or indirectly and cost-efficiently reduce greenhouse gas emissions;

- the investment conforms to the National Investment Plan;

- the investment complies with the relevant EU legislation. The investment must not strengthen the dominant position of the operator on the electricity generation market nor cause an unjustified distortion of competition;

- the investment is an addition to investments which Hungary has to perform in order to achieve other objectives or fulfil legal requirements arising from EU legislation. The investment must not increase the total capacity of electrical energy production in Hungary in the period from 2013–2020;

- the investment shall diversify the energy and supply sources for electrical energy production and shall reduce the greenhouse gas emissions from energy production;

- the investment shall remain economically sustainable also after 2019; and

- the market value of the free emission allowances applied for is equivalent to or lower than the cost of the investment to be performed according to the application.

12. The two investment projects in the national plan were chosen on the basis of an open, transparent and non-discriminatory, procedure and they aim at the modernisation of the electricity system in Hungary. The two selected investments are a Smart Grid Pilot Project and a Gas Interconnector between Slovakia and Hungary.

13. The Hungarian authorities have provided the summary of the public consultation on the selection of investments carried out in 2011 involving the owners of all power plants in Hungary. The summary shows that most of the project ideas on the generation, storage or balancing level (including the construction of a pump storage power plant) would have been too costly to be undertaken individually by one company. However the competitors could not agree on how these projects and their benefits should be controlled mutually, besides many other competitors strongly opposed the idea of a mutual project. The study also sets out other projects to be carried out on the operator's level individually, nevertheless the operators could not prove that they would not carry out the projects without the Article 10c funds in any case. Other projects were not elaborated or were presented as mere ideas. Based on its assessment of the replies to the questionnaire, the Hungarian Government decided in favour of the abovementioned system-level investments, namely projects that serve the modernisation of the Hungarian electricity system, including in particular the modernisation of the Hungarian electricity generation as a whole.

14. The Hungarian authorities confirmed that in order to monitor and enforce the planned two investments pursuant to the national plan, a mechanism will be established in the national law[2]. On the basis of this legislative instrument and in accordance with Article 10c(1) of the EU ETS Directive, Hungary foresees that in exchange for receiving the allowances, operators are obliged to transfer a financial amount equivalent to the market value of the allowances to the Monitoring Authority. The transparent use of Article 10c funds by the investors is envisaged as payments to the investors can only be made on the basis of a written and substantiated transfer request approved by the Monitoring Authority and the principle of ex-post transfers. In particular: the national law provides for a general rule, according to which no investment shall be financed in excess of the amount of Article 10c funds. According to the Hungarian notification, this general rule was introduced to ensure that if the actual market value of the allowances exceeds their originally estimated market value and, therefore, the amount of available financial support exceeds the amount

[2] See recital 18.

of Article 10c funds, the investors will not be eligible to receive financial support through the Article 10c mechanism in excess of the amounts set out in the Hungarian application. In such a case, the excess amount of the 10c funds will be transferred by the Monitoring Authority to the Hungarian State Budget with the purpose of supporting climate change policy objectives set forth in the EU ETS Directive. The same applies if the investments listed in the national plan do not to incur costs exceeding the market value of the Article 10c funds.

15. The granting authority, as well as the institution responsible for collecting and allocating funds and for monitoring and enforcing the measure, is the the Monitoring Authority.

16. The Monitoring Authority will require the beneficiaries to report on a regular basis, twice a year by 30 June and 5 January on the implementation of their investments referred to in the national plan. Mandatory elements for the report are a list of expenditures made in relation to the investment, the total amount of Article 10c funds received for the carrying out of the investment, a progress report summarising the progress which has been made in the implementation of the investment, any extraordinary or unforeseeable events that hindered the carrying out of the investment and a planned investment schedule relating to the activities intended to be performed by the investor in the coming year. The Monitoring Authority shall appoint an auditor to audit the performance of the investments (the Independent Auditor) by 30 June 2013 via a public procurement procedure. The Independent Auditor shall examine the investor's costs and operations associated with the investments during the actual year. The result of this examination will be summarized by the auditor in an officially stamped document including a verification of the nature of investment, a verification that in the actual year the investment met the requirements laid down in the EU ETS Directive, the Commission's Communication "Guidance document on the optional application of Article 10c of Directive 2003/87/EC"[3] ("the Communication") and the national plan, a verification of the investor's costs spent for the investment during the actual year, and a verification that such costs truly incurred. The investor's annual report to the Monitoring Authority shall be valid only if it includes the Independent Auditor's report. In addition, the National Inspectorate for Environment, Nature and Water shall carry out periodical controls on the site of the investment at least once per year. Hungary shall submit a national report to the Commission yearly and shall make such reports public on the website of the National Inspectorate for Environment, Nature and Water.

2.3. Scope of the notification and legal basis

17. The measure subject to this notification concerns the funding of investments in the scope of diversification of the energy mix and sources of supply through the free allocation of greenhouse gas emission allowances to electricity generation installations, with the aim to reduce greenhouse gas emissions and to modernise Hungary's electricity generation system.

18. The primary legislative instrument is the Act on the implementation of the revised the EU ETS Directive (the New GHG Act) which shall regulate the fundamental rules of the balancing mechanism which shall set out how the electricity generators receiving directly free allowances must transfer the total value of these allowances to the Monitoring Authority

[3] OJ C 99, 31.03.2011, p. 9

and how the investors may receive financing for the investments identified in the national plan[4]. This New GHG Act will repeal the current Act on Greenhouse Gas Emissions. The detailed rules of the derogation mechanism, including the further details of the balancing mechanism will be regulated in an implementing decree to be adopted by the Hungarian Government (the Implementing Decree). The provisions of Directive 2003/87/EC and Directive 2009/29/EC shall be transported into Hungarian legislation through the above legal instruments once the European Commission approves the scheme.

2.4. Beneficiary, form of the aid, aid intensity

19. The state aid takes the form of free allocation of emission allowances within the meaning of Article 10c of the EU ETS Directive.

20. Following an invitation by the Hungarian Government to submit an application, potential beneficiaries of state aid in the form of free allowances were selected, based on two cumulative criteria: first, they must own an electricity generator which produces electrical energy with a built-in capacity exceeding 50 MW; and second, such installation must be included in the EU ETS and must have been put in operation by 31 December 2008, or the investment related to the installation must have been physically initiated by that date.

21. The Hungarian Article 10c application deliberately does not support the retrofitting of operating fossil fired power plants, nor the construction of new fossil fuelled power plants, but supports two investments with an expected modernisation impact at the system level, upstream of gas and electricity supply markets. Therefore the Hungarian State applies the possibility provided under points (29) and (43)[5] of the Communication and designated the two project companies for undertaking the investments identified in the Hungarian national plan. These entities are not installations for electricity production in the sense of Article 10c of the EU ETS Directive. Consequently they cannot receive free allowances directly.

22. Installations receiving the free allocation based on Article 10c of the EU ETS Directive shall transfer a financial amount equivalent to the market value of the allowances to the Monitoring Authority, from which the two investments in the national plan will be financed. The counter value of the free allowances is established using either the market value of the allowances laid down in Annex VI to the Communication or the market value based on a specific methodology approved by the Commission in its Decision of 30 November 2012 (see recital 6 above).

23. The counter value of free allowances will be used for performing the selected investments[6], which will be undertaken by companies other than the ones receiving free allowances. The beneficiaries of the countervalue of the free allowances are Magyar Gáz Tranzit Zrt. (for the construction of the Interconnector) and MAVIR Zrt. (for the Smart Grid pilot project).

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4 See recital 12.

5 Member States may decide which investments would best contribute to the modernisation of the electricity generation sector. The national plan may as well contain investments to be undertaken by companies which are not involved in the generation or supply of electricity, such as network operators which, however, have to be fully unbundled from the production of electricity.

6 Hungary's national plan can be found at the following address: http://www.kormany.hu/hu/dok?page=4&source=7&type=306#!DocumentBrowse

Magyar Gáz Tranzit Zrt. was established on the 1st of January 2012 and is owned by MVM Zrt.[7] and MFB Invest Zrt.[8]. Both shareholders of Magyar Gáz Tranzit Zrt. are state-owned legal entities, MVM Zrt. being a company with the activities of production, distribution and sale of electricity, whereas MFB Invest Zrt. performs domestic and international development and venture capital financing activities. The Hungarian authorities explained that when incorporating Magyar Gáz Tranzit Zrt. the shareholders envisaged to meet the unbundling criteria laid down in the European Union's third energy package[9]. The Smart Grid pilot project will be implemented by a project company exclusively owned by MAVIR Zrt., the Hungarian transmission system operator.. MAVIR Zrt is majority owned by MVM Zrt. However MAVIR Zrt. as a transmission system operator is also regarded and treated as an independent company from MVM Zrt. in accordance with the European Union's third energy package.

24. At its inception, in 2013, total free allowances will not exceed 70 per cent of the verified greenhouse gases emissions in the period 2005-2007 from electricity installations for the amount corresponding to the gross final national consumption of Hungary and no transitional free allowances will be allocated from 2014 onwards, i.e. the allocation is limited to the sole year of 2013. The quantity of transitional free emission allowances will be deducted from the quantity of allowances that Hungary will auction pursuant to Article 10 of Directive 2003/87EC.

25. As notified by the Hungarian authorities, the total market value of the free emission allowances allocated is estimated to be about EUR 56 million over the period 1 January 2013 to 31 December 2013. This value corresponds to approximately 7 million tons of CO_2. The market value will be defined *ex ante* by the Monitoring Authority applying objective, non-discriminatory and transparent criteria. If the market price established with this methodology is at least 20% lower than the corresponding price in Annex VI of the Communication, this calculated price will be used. The reference market value will be determined once and will be based on volume weighted average prices of three emission futures markets[10] trading with allowances. This reference value will be made public. Otherwise the price in Annex VI of the Communication shall be applied. According to Hungarian authorities the monitoring mechanism will ensure that no windfall profits or overcompensation arises.

2.5. Allegations of MEHI

26. MEHI sent a complaint to the Commission alleging that the aid measure is in conflict with EU State aid rules. The complainant contested one of the three investments in the (pre-notified) National Plan: a pump storage power plant (the PSPP), operated by the likely dominant incumbent and the allocation mechanism of the free allowances, in particular the fact that an intermediary body responsible for the allocation (the Broker) was likely to be a state body and as a result the state would lose state resources by selling the allowances at a much lower price than the original purchase price set out by Annex VI of the Guidance Communication on the ETS Directive Article 10c mechanism. Based on the Hungarian

7 See: http://english.mvm.hu/Engine.aspx
8 See: http://www.mfbinvest.hu/mainpage
9 See in particular Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC
10 The market prices during the period between 1 January 2013 and 28 February 2013 of ICE, GreenX and EEX.

national plan finally notified, the complaint has become devoid of object: the contested PSPP project was finally excluded from the national plan and a newer balancing mechanism proposed by Hungary no longer includes the Broker mechanism in the allocation procedure. Accordingly, the allegations are not further examined hereinafter.

3. ASSESSMENT

3.1. State aid within the meaning of Article 107(1) of the TFEU

27. State aid is defined in Article 107(1) TFEU as any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods in so far as it affects trade between Member States.

28. As indicated in the Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme (hereinafter "the ETS Guidelines"),[11] in particular point 3, the allocation of optional transitional free allowances in the electricity sector in the context of implementing the ETS Directive by eligible Member States may involve State aid within the meaning of Article 107(1) of the TFEU and, in accordance with Article 108 of the TFEU, must be notified to and may not be put into effect until it is approved by the Commission.

29. In the case at hand, the measure is imputable to Hungary as it results from acts of government making use of the derogation allowed, but not required, by Article 10c of the EU ETS Directive.[12] The granting of free allowances to the planned beneficiaries foregoes State resources which would accrue to Hungary if the allowances were auctioned. Meanwhile, the beneficiaries of the free allowances are relieved of the costs of buying the necessary allowances, thereby obtaining an economic advantage. The same is true as regards the beneficiaries, which are partly relieved of the costs of the selected investments which they would need otherwise to bear.

30. Furthermore, the advantage is selective since only the two beneficiaries selected by the Government, which undertake to carry out the modernisation investments and meet the conditions set out in the national legislation (see recital 18) are entitled to it, unlike other undertakings active in the electricity or other economic sectors covered by the EU ETS. As the beneficiaries are active in the supply and transmission of energy, which are markets open to competition in Hungary and involving trade flows between Hungary and other Member States, the measure distorts or threatens to distort competition and is liable to affect trade between Member States.

31. Accordingly, the Commission concludes that the notified measure constitutes State aid within the meaning of Article 107(1) of the TFEU.

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[11] OJ C 158/4, 5.6.2012

[12] See also the Court judgments on the Stardust Marine case (T-360/04), Sandra Puffer (C-460/07) and Deutsche Bahn (T-351/02).

3.2. Lawfulness of the aid

32. The Hungarian authorities confirmed to the Commission that the aid under this scheme will be granted only after its approval by the Commission. By notifying the measure before its implementation, the Hungarian authorities have fulfilled their obligation according to Article 108(3) of the TFEU.

3.3. Compatibility of the aid

33. The Commission has assessed the compatibility of the notified measure according to Article 107(3)(c) of the TFEU and in light of the ETS Guidelines.

3.3.1. Incentive effect, eligible costs and aid intensity

34. According to the Hungarian application pursuant to Article 10c (5) all investments listed in the national plan will have been undertaken after 25 June 2009. The requirement that the state aid has an incentive effect is therefore fulfilled.

35. The Hungarian national plan includes two eligible investments the costs of which are limited to the total investment costs (tangible and intangible assets) irrespective of operating costs and benefits of the corresponding installation. According to the Hungarian notification, the funds granted to the investors by the Monitoring Authority[13] shall not exceed the total investment costs. The monitoring and enforcement mechanism proposed by Hungary ensures that the allowances allocated under Article 10c are clearly mirrored by investments in the modernisation of the electricity generation sector. Therefore the aid does not exceed 100 % of the eligible costs.

36. Consequently the conditions as to incentive effect, eligible costs and aid intensity laid down in points 40, 41 and 42 of the ETS Guidelines are met.

3.3.2. Assessment of the criteria under point 40 (a) to (d) of the ETS Guidelines relating to the methodology, the common interest, the type of investments and the total value of allowances allocated

37. According to point 40 of the ETS Guidelines, state aid involved in transitional and optional free allowances for the modernisation of electricity generation and the investments included in the national plans, in accordance with Article 10c of the EU ETS Directive, will be considered compatible with the internal market within the meaning of Article 107(3)(c) of the TFEU provided that five cumulative conditions are met: (a) the transitional free allowance is granted in accordance with the methodology specified in the Commission working staff document of 26.05.2010;[14] (b) the national plan pursues an objective in the common interest; (c) the national plan includes investments in upgrading of the infrastructure, in clean technologies and in diversification of their energy mix and sources of supply; (d) the market value of free allowances does not exceed the total costs for

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[13] Calculated in accordance with the Commission Decison of 29 March 2011 on guidance on the methodology to transitionally allocate free allowances to installations in respect of electricity production pursuant to Article 10c(3) of Directive 2003/84/EC, C(2011) 1983 final

[14] OJ C 99, 31.03.2011, p. 9.

investments undertaken; and (e) the aid does not adversely affect trading conditions to an extent contrary to the common interest.

38. In the remainder of this section, the Commission will look at whether these criteria can be deemed to be fulfilled.

39. The Commission assessed the methodology, the existence of a common interest, the type of investments committed and the total number of allowances allocated in its Decision of 30 November 2012 (see recital 6 above). In that decision, the Commission found as follows:

- The application of Hungary pursuant to Article 10c(5) of the Directive, was notified to the Commission on 30 September 2011. Hungary submitted additional information in order to complete the notified plan by e-mail transmitted on 16 January 2012 in reply to questions from the Commission, by e-mail transmitted on 31 May 2012, and by letter of 9 November 2012.

- The Hungarian application, including the total maximum quantity of allowances of 7.047.255 proposed to be allocated to installations pursuant to Article 10c in year 2013, has been assessed against the criteria set out in Article 10c of the Directive, taking into account the Communication and the Commission Decision of 29 March 2011 on guidance on the methodology to transitionally allocate free emission allowances to installations in respect of electricity production pursuant to Article 10c(3) of Directive 2003/87/EC[15] (hereinafter "the Decision").

- In accordance with Article 10c(1)(c), in 2006, more than 30% of electricity in Hungary was produced from a single fossil fuel, and the GDP per capita at market price did not exceed 50% of the average GDP per capita at market price of the Union. Hungary may therefore use the option provided for by Article 10c of the Directive.

- Together with its application, the Hungarian authorities provided a list of 16 installations eligible to transitionally receive allowances for free. Hungary proposes to allocate the free emissions allowances to those installations only in 2013. Allocations to the installations on the list will take place in accordance with the requirements of Article 10c(3) of the Directive and Article 1 of the Decision.

- As part of its national plan, Hungary has proposed two investments relating to the diversification of the energy mix and sources of supply. The proposed investments have been undertaken from 25 June 2009 or will be undertaken in the future. They comply with the requirements of Article 10c(1) and are compatible, to the extent possible, with the principles set out in point 23 of the Communication. They are therefore eligible for being financed by the value of the allowances allocated pursuant to Article 10c.

- The Commission has also examined the provisions with regard to monitoring and enforcement as regards the intended investments. In particular, Hungary proposes to issue the allowances to the operators and oblige them to transfer the amount equivalent to the market value of the allowances to a dedicated Monitoring Authority. Hungary intends to

15 C(2011) 1983 final

appoint the National Inspectorate for Environment, Nature and Water to act as the Monitoring Authority. The funds collected by the Monitoring Authority, with the exception of the part covering its operational expenses, will then be used to finance the investments provided in the national investment plan. Hungary commits itself to ensure that payments of the funds by the Monitoring Authority will only cover the expenses already made in the investment process. According to the Hungarian application, pre-financing of investments is not allowed.

- Hungary is of the view that in case the market value of the allowances laid down in Annex VI to the Communication is significantly different from their prevailing market value, another market value should be used to determine the amount that an operator has to transfer to the Monitoring Authority following the issuance of the free emission allowances. Therefore, where a reference market value is more than 20 % lower than market value laid down in Annex VI to the Communication, Hungary proposes to use the former instead. The reference market value will be determined once and will be based on volume weighted average prices of three emission futures markets trading with allowances, as indicated in the application, during the period between 1 January 2013 and 28 February 2013. This reference value will be made public.

- The provisions proposed by Hungary allow close monitoring and effective enforcement of the national plan and ensure that the allowances allocated under Article 10c are clearly mirrored by investments in the modernisation of the electricity generation sector. In particular, the Commission notes that the methodology to determine the alternative market value is based on objective, non-discriminatory and transparent criteria. Investments are subject to the competent authority's scrutiny and proper reporting to the Commission in accordance with Article 10c(1) and (4) is foreseen. Therefore, the Commission considers this mechanism sufficient to ensure proper execution of the investments identified in the national plan.

- In the Decision of 30 November 2012, the Commission further took the view that the allocation of free allowances as proposed by Hungary in its application does not result in undue distortions of competition within the meaning of Article 10c(5)(e) of the Directive as it is consistent, in particular, with points 11 and 44 of the Communication. However, the scheme set out in the application must be implemented in accordance with Directive 2003/87/EC and with other relevant provisions of Union law including Directive 2001/42/EC and Directive 2009/73/EC. Hungary may in accordance with Article 10c(2) of the Directive reduce the total transitional free allocation foreseen in the application provided that no inconsistency with the Directive or other Union law is thereby created. This decision is also without prejudice to measures taken at national level, in compliance with Union law, relating to the national energy policy and to the right of Member States to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply.

40. For the reasons above, the Commission concluded in its Decision of 30 November 2012 that the criteria listed under points (i) to (iv) of Article 10c(5) of the ETS Directive were met.

41. Accordingly, in the light of the above and for the reasons explained in its Decision of 30 November 2012, the Commission considers that the methodology used to calculate the value of transitional free emission allowances, the common interest pursued through their

allocation, the type of investments included in the projects and the overall value of emission allowances are in line with the requirements set in the ETS Directive to justify the use of State aid. The conditions set out under point 40 (a) to (d) of the ETS Guidelines are therefore complied with.

3.3.3. Potential distortions of competition and trade

42. In line with Article 107(3)c) TFEU, and pursuant to point 40 (e) of the ETS Guidelines, the Commission needs to consider whether the notified measure does not adversely affect trading conditions to an extent contrary to the common interest, in particular where aid is concentrated on a limited number of beneficiaries or where the aid is likely to reinforce the beneficiaries' market position.

43. The Commission notes that, in general, the mechanism of allocating emission allowances favours existing undertakings carrying out electricity generation from fossil fuels. Those undertakings which already have a significant market presence through fossil fuels are likely to get a higher number of allowances. However, in the case at hand the open, transparent and non-discriminatory proceedings for selecting the beneficiaries[16] mitigate possible distortive nature of the scheme. An analysis of the distortive impact of the national plan must take into account the pre-existing market structure and the degree to which the national plan, by using the investments made possible through the allocation of allowances, alters it, preferably leading to a path towards a more pro-competitive environment.

44. An important feature of the Hungarian plan is that the Hungarian state decided to opt for promoting system-level investments as opposed to operator-level investments under the derogation rules of Article 10c of the EU ETS Directive. The selected investments will therefore have mainly an effect upstream of the markets for, respectively, electricity generation and gas supply. Moreover, based on the procedure and criteria for selecting the investments and the reasons alleged by Hungary and portrayed at recital 13, the quite strict limitation of the number of beneficiaries and the absence of any additional projects aimed at the modernisation of electricity generation are duly justified.

45. The market of electricity generation in Hungary is somewhat concentrated in absolute terms, with a HHI of concentration of 1 830, yet relatively below the levels observed in many other Member States. In the Hungarian Article 10c application, the Hungarian Government limited the group of electricity generators who may participate in the free allocation to the electricity generators with a built-in capacity exceeding 50 MW (the large power plants)[17]. According to Table 1 below, the market share of the biggest electricity producer participating in the free allocation in Hungary is just below the 40% (i.e., a market share above which, when examined together with other factors, a possible dominant position may arise[18]).

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16 See recitals 11-12.

17 Since the investments will not be carried out at the operator's level but they target the modernisation of the system and the allocation must be refinanced by the operators, Hungary excluded the smallest power plants (built in capacity < 50MW) from the allocation who would not benefit from the allocation itself however they might be financially vulnerable due to their size thereby jeopardizing the financing of the two projects in the national plan.

18 Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7., points 10 and 14.

Table 1: Market share in electricity generation in 2011 for power plants participating in the free allocation under Article 10c of the EU ETS Directive

Majority owners of the large power plants (> 50 MW)	Market share of investor groups in 2011 (%)	Gross electricity production by investor groups in 2011 (MWh)
MVM	39.20%	16,735.6
RWE	15.30%	6,516.7
ALPIQ	4.40%	1,870.3
GDF SUEZ	3.70%	1,589.9
E.ON	3.10%	1,325.6
Edf	2.90%	1,249.8
AES	2.90%	1,249.0
Donbass	0.30%	111.3
Civis Capital	0.30%	110.2
Euroinvest	0.20%	90.3
Dalkia	0.10%	54.0
Total	**100.00%**	**30,895.7**

Source: Hungarian authorities

46. Moreover, the implementation of the investments included in the national plan is not expected to discernibly impact the position of market players by 2020. As further explained below, the positive effects on competition downstream and increased interconnection within the internal market triggered by the planned investments are likely to outweigh the distortions of competition on transmission markets which the aid might cause.

47. The planned transmission interconnector between Slovakia and Hungary conforms to the objectives of EU policy as to security of supply and interconnection of energy networks in the Union enshrined in Article 194 b) and d) TFEU. The investment would be undertaken on the gas transmission market where the transmission of gas is operated by the sole transmission system operator called FGSZ which is jointly controlled by E.ON and MOL. Neither E.ON nor MOL hold any shares in MVM Zrt. whose project company[19] would carry out the investment. The Commission considers that the question whether the project company meets the unbundling criteria laid down in the European Union's third energy package shall be assessed by the Commission in separate proceedings.

[19] Magyar Gáz Tranzit Zrt., see recital 23

48. As portrayed in table 2 below, the market share of the new entrant will be low on the Hungarian market of gas transmission, as it is expected to represent 26.3% of trans-border capacity while the remaining 73.6% is held by FGSZ, the main transmission network operator. In addition, the market power of MVM shall be further limited as the interconnector cannot by-pass the pipelines of the Hungarian network due to its dependence on accessing the rest of the Hungarian network. In addition, the operator of the interconnector (Magyar Gáz Tranzit Zrt.) shall allow access to the pipeline for all market players without any restriction. There will not be reserved capacity either for the operator company or other participants but the capacity will be offered according to third party access regulation.

Table 2: Market players with the planned interconnector on the Hungarian gas transmission market

Market players	Length of the transmission network operated	Capacity of the transmission network operated	Market share
FGSZ			
Total capacity	**5782 km**		**98.46%** (lengths)
Interconnectors	372 km	14 bm3/year	80.2% (lengths) 73.6% (trans-border capacity)
Magyar Gáz Tranzit Zrt.			
Total capacity	**92 km**	**DN 800 PN 75 5 bm3/year**	**1.56%** (lengths)
Interconnector	92 km	DN 800 PN 75 5 bm3/year	19.8% (lengths) 26.3% (trans-border capacity)

Source: Hungarian authorities

49. On the other hand, the new interconnector could in turn allow for new entry and/or increased competition on the Hungarian gas supply market, based on new sources of supply available to market participants on a non-discriminatory basis. In that respect, Hungary claims that the gas prices will presumably drop and power plants would have a better bargaining power due to the diversification of sources. Such impacts could facilitate the implementation of new and modern power plant investments.

50. The other investment (Smart Grid pilot project) in the national plan will be implemented by a project company exclusively owned by MAVIR Zrt. which is the Hungarian electricity transmission system operator within the MVM Group. Hungary demonstrated that this smart grid project is a pilot project[20] with the primary aim to examine the feasibility and economic advantages of the nationwide deployment of smart grids on the factual assumption that smart grids contribute to the development of economically efficient and sustainable power systems and, thereby, to the achievement of lower power losses, higher quality, cheaper service, greater safety and increased security of supply. Therefore the direct economic advantages of the project will primarily consist of cost savings by the consumers participating in the project.

51. The fact that the project has a pilot nature is expected to have a limited negative effect on competition. The impact of the project on competition on the electricity generation market is further mitigated by the fact that the investment will be implemented by a subsidiary of the Hungarian transmission system operator, MAVIR Zrt. The project mainly deals with operational development of an existing technology, which could be useful for each market player, by increasing the efficiency of the system operation in the Hungarian power system. Hungary also provided evidence that the know-how acquired in the course of the implementation of the smart grid project will be shared with the Hungarian Energy Office, and, thereby, with the relevant market players. Accordingly, the selected investment is unlikely to significantly affect the competitive structure of the market for electricity supply portrayed at table 1.

52. For the reasons listed above, the Commission concludes that the positive effects of the notified measure offset its negative effects, and that the potential distortions caused by the measure do not alter market conditions to such an extent as to be contrary to the common interest.

4. CONCLUSION

53. In the light of the foregoing, the Commission concludes that the notified aid is compatible with the internal market in accordance with Article 107(3)(c) of the TFEU and has therefore decided not to raise objections to it.

54. The Commission reminds the Hungarian authorities that, in accordance with Article 108(3) TFEU, plans to refinance, alter or change this scheme have to be notified to the Commission pursuant to provisions of Commission Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 [now 108] of the TFEU.[21]

[20] The Smart Grid Pilot Project will be implemented in two phases in 2013 and 2014.
[21] OJ L 140, 30.4. 2004, p.1.

55. If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

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Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
B-1049 Brussels
Fax No: 32 2 296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President